STATE GUARANTY OF BANK DEPOSITS IN NEBRASKA

ONE of the amendments to the Currency Bill, proposed by the Owen Committee in the Senate, provided for the setting aside of one-fourth of the earnings above six per cent of the Federal Reserve banks, for the purpose of paying the depositors of failed national banks. In debating this plan, its advocates, especially Senators Hitchcock, Bristow and Reed, cited freely the state guaranty systems of Oklahoma, Nebraska, Kansas and Texas, asserting that these had proved entirely satisfactory and drawing the inference that national bank guaranty would be equally practicable.

After the Currency Act was passed, without the guaranty clause, the three Senators referred to were appointed as a Subcommittee on the Guaranty of Bank Deposits, in order that they might continue their efforts for the protection of national bank depositors. Senator Hitchcock, as chairman of this subcommittee, presented on June 23 last a *History of Guaranty of Bank Deposits*, by George H. Shibley, in which, after reviewing statements by the bank commissioners of the states having the guaranty, quoting their various statutes, and drawing liberally from the articles by Mr. Thornton Cooke in this Journal,[1] Mr. Shibley drew the rather unequivocal conclusion that "the guaranty of bank deposits has now become a demonstrated success, taken as a whole."

Considering that the state systems have been legally in effect only three years and a half; that the Oklahoma fund in that time ran $375,000 behind its assessments, tho the latter averaged four-fifths of one per cent a year of the total deposits; and that in the other three states, crops and financial conditions have been so favorable that only about a half-dozen small failures have occurred in all, it would seem that the champions of national bank guaranty are using the argu-

[1] See vol. xxiv, "The Insurance of Bank Deposits in the West," and vol. xxviii, "Four Years More of Deposit Guaranty."

ment from example almost before the example exists. The experience of the states which are trying the guaranty system will certainly be of the greatest worth in demonstrating which method, or combination of methods — for the various systems differ considerably in detail — will be the fittest to survive; but the term "survivor" can hardly be applied to any of them until they have met the tests of short crop years, industrial depressions, and serious financial crises.

The course of guaranty in Nebraska, where agitation for it was begun long before the issue came into national prominence, shows what may be expected of such a system while it is new, working under favorable conditions. A brief sketch will here be given of the conditions which led to the law of 1909, as well as its effects, so far as they are apparent, and of the details of the method by which depositors are paid.

Banking in Nebraska, from territorial times in the '50's up to the first state supervision in 1886, was a good deal of the kind called "wild-cat," yet failures were not so very numerous. In the "hard time" years of 1892 to 1896, however, came short crops and a nation-wide financial depression; and this produced a contraction of credits which swept 101 of the 650 state and national banks into insolvency. The claims against these institutions aggregated over $5,000,000, on which it is estimated about $2,000,000 were finally paid. The total deposits fell off from $49,000,000 to $27,000,000 in that six-year period.

It was the bitter experience in these years which led to the first agitation in the state for the guaranty of deposits. It is said that the president of the largest failed bank was the first man to suggest it, writing a letter to the newspapers outlining a plan, from the jail where he was awaiting trial for wrecking his bank. Secretary W. J. Bryan, then Congressman from the First District, introduced a bill for national bank guaranty into Congress in 1893. Guaranty bills were brought up in the Nebraska legislatures of 1897, 1899, 1905 and 1907, all of them crude and unscientific measures, with

no limit to the amount a bank might be assessed within one year. They were all opposed, of course, by the bankers, who saw from the record of '91 to '96 what an unlimited guaranty might cost them if a repetition of those hard times should occur.

The panic of 1907, however, and the adoption of the Oklahoma law which followed, added so much impetus to the movement that, altho no banks had failed in Nebraska on account of the panic, Mr. Bryan and the Democratic state leaders in 1908 were able to arouse enthusiasm over the guaranty plank in their platform. It is difficult to say what the result of the election would have been if the issue between Democrats and Republicans had been really on that plank. Probably the chief reason why a Democratic majority was sent to the legislature that year was the personal strength of Mr. Bryan at the head of the ticket. He lent his support to the measure after election, as did also the governor, and the party redeemed its pledge by enacting it into law. The law was enjoined from operation by the Federal Court until January, 1911, when the Supreme Court of the United States upheld its constitutionality in common with the guaranty laws of Oklahoma and Kansas. Its general provisions, as slightly amended by the legislature of 1911, are as follows.

The Depositors' Guaranty Fund of Nebraska is to accumulate up to one and one-half per cent of the average daily deposits for the whole state, at the rate of one-half of one per cent for each of the first two years, then one-tenth of one per cent until the limit is reached, at which time assessments are to stop. No money is actually paid out by any bank except its proportionate share of losses arising from failures; the assessments are simply charged off from its profits and entered to the credit of the Depositors' Guaranty Fund, which can be drawn upon by the State Banking Board. In case the fund becomes exhausted, emergency assessments may be made by the Board up to one per cent in any one year. Depositors in a failed bank are to be paid out of the fund as soon as the district court in charge of the receivership determines, from the claims filed, the amount of cash necessary, in

addition to that on hand in the bank itself. The fund is then reimbursed, so far as possible, by the sale of the failed institution's assets.

The effects of the law from 1909 to the beginning of 1914 were based chiefly on bankers' and depositors' guesses as to what the final results would be. During the first year bankers seemed, on the whole, to consider the business-getting qualities of the guaranty more than worth the premiums involved, for fifty-five new state banks were chartered, and only five former state banks became national to escape the law. Depositors were not much affected, one way or the other, for the deposits in both classes of banks, which had been exceptionally low in 1908 on account of the panic the year before, increased greatly in 1909, with little advantage to either.[1] In 1910, while the constitutionality of the law was still in doubt, the number and deposits of national banks grew considerably; 28 new state banks were chartered, but 8 of the old ones nationalized, and their aggregate deposits fell off over a million dollars. The law was upheld by the Supreme Court in January, 1911, and that year 24 state banks were chartered, 11 nationalized, and the national banks gained a million more deposits than the state. A number of state banks had also gone out of business by other processes than nationalizing, so that at the close of 1911 the state banks, as compared with their position two years before, were ahead in number only 7, in aggregate capital

[1] Items from statements of state and national banks at the end of years mentioned (taken from reports of the Secretary of the State Banking Board):

At End of Year	Number of	Capital	Loans	Individual Deposits
STATE BANKS				
1908	628	$10.9	$55.7	$65.4
1909	662	12.0	66.0	71.7
1910	666	12.5	67.9	70.4
1911	669	12.8	67.5	72.2
1912	694	13.8	78.2	80.7
1913	714	14.4	84.9	89.3
NATIONAL BANKS				
1908	214	$13.5	$75.9	$73.0
1909	220	14.4	89.8	83.8
1910	238	15.4	92.1	86.4
1911	247	16.2	95.0	89.0
1912	243	16.2	103.6	93.4
1913	241	16.27	102.9	94.6

The figures for capital, loans, deposits signify millions of dollars, e.g., $10.9 = $10,900,000.

only $800,000, and in deposits $500,000; while their national competitors had added 27 banks, nearly $2,000,000 capital, and more than $5,000,000 of individual deposits.

In 1912, 1913, and the first half of 1914, however, the drift was steady and rapid in favor of the state banks, indicating that these were becoming more popular with depositors, and that bankers were finding this system a little more advantageous than the other. The number of state banks increased about 70 in that period, while the total number of nationals fell off 17. Between January, 1911, when the guaranty law went into effect, and the middle of 1914, the individual deposits of state banks increased about 19 millions, or 27 per cent; as compared with a 7 million gain for the nationals, which is about 8 per cent.

The almost equal confidence in which both classes of banks were held, during this period, by the people, was due in a large measure to the fact that no failures whatever had taken place within the state for six years. In the past ten years there had been but three small state bank crashes, which did not attract much attention, and no national bank had become insolvent in fifteen years. During the first half of 1914, however, the movement of business toward state banks was greatly accelerated by two circumstances: the first case of immediate payment of depositors in a failed state bank presented a striking contrast to the delay and uncertainty of two national liquidations, one of the latter in the same town; and the Federal Reserve Act was passed, containing provisions so distasteful to several Nebraska nationals that they converted into state banks.

The First National Bank of Sutton, with about $180,000 deposits, was the first to fail, in November, 1913. Two months later the First National of Superior was closed, having over $300,000 deposits. The former seems to have suffered from the criminal actions of some of its officers, the latter from a policy of injudicious extension of credit. The First State Savings Bank of Superior, under practically the same ownership as the national, was able to survive the shock only three months, and was taken charge of by the State Banking

Board on March 9, 1914. Its deposits amounted then to about $122,000.

When the state banks heard of this latter failure, they grasped its advertising value to themselves, and instead of being reluctant to contribute their share of what would be required from the guaranty fund, many of them wrote to the Secretary's office urging that the depositors be paid in full as soon as possible from the guaranty fund, so that they could point with pride to this example of how the state banks' customers were protected from loss. But there was no way by which the Banking Department could hasten matters. The law requires that at least three weeks be allowed for the filing of claims, and that an order of court be secured before the fund is drawn upon; so depositors cannot, ordinarily, expect to get their money within six weeks to two months.

In this case, however, a development occurred by which the depositors of the Superior state bank were paid as fast as they presented their claims, without even a day's delay. During the interval between the two failures, the other national in Superior converted into a state bank. When the receiver of the insolvent bank took charge and it was found that no cash could be had from the guaranty fund for a month or so, this newly reorganized State Bank of Superior offered to supply whatever cash was needed, in addition to the $23,000 that was on hand when the savings bank closed, to pay all depositors who needed their money. Their claims were assigned to the new state bank, so that it could collect them in the regular way from the receiver as soon as the money from the fund was sent to him. This was of course a considerable accommodation, and the result was that the enterprising institution secured the larger portion of the business which had formerly gone to the savings bank. People from neighboring towns were a little anxious, but the patrons living in the vicinity of Superior made very little effort to draw out their money. Many of them had not presented their claims more than two months after the closing.

The likelihood of other banks accepting the claims without discount, because of the certainty of their being paid out of

the fund, was apparently not anticipated by the early advocates of the plan; but so strong is the inducement to people to leave their money on deposit with the bank which accepts their claims, that a similar action may probably be looked for in the future. If the practice does become general, the disturbance by failures to local business will be greatly lessened, which will be no small achievement for the guaranty system.

As soon as the receiver found that a trifle over $54,500 would be required, in addition to what cash there was on hand in the bank, he called on the State Banking Board for this amount out of the guaranty fund. The Board had his report approved by the District Court in charge of the receivership, and then proceeded to draw upon every state bank in Nebraska for its proportionate share of the sum needed, which was .06241 of its credit to the guaranty fund. The accountant in the Secretary's office was overwhelmed with all these decimal calculations, until he finally discovered a machine with which he could grind out the assessments by turning a crank. The seven hundred-odd drafts were sent, about fifty days after the failure, to the receiver, who turned them over to the State Bank of Superior in return for the claims of like amount which it had bought up. It is expected that the sale of assets and assessment on stockholders will be sufficient finally to reimburse the fund.

In contrast to this tranquil experience for depositors in the state savings bank, is the misfortune of depositors in the First National of Superior, and of the national at Sutton. The latter bank has paid a dividend of ten per cent, the Superior national has so far (July 23) paid nothing. Consequently their creditors are still waiting for returns on some $360,000 which they had delivered over to these banks in hard cash, and they may count themselves very fortunate if they get seventy-five per cent of it after several long years of waiting. It is easy to believe the following statement by one of the officers of the State Bank of Superior, the reorganized national:

"The feeling down here is all state bank now, and the last national in the county changed over to a state bank last week. . . . It

does n't make so much difference in the city, where you deal entirely with business men, but where your dealings are mostly with farmers, it 's another proposition. There was n't a bank in the state that had the confidence of the people that the First National of Superior had. This confidence has been shattered, and now the cry is ' Money guaranteed ' or nothing." [1]

Several other banks in that section of the state thought best to make the same concession to the preferences of their patrons as did those of the above (Nuckolls) county. The City National of Holdrege, a fairly large country bank in a town at some distance from Superior, changed to a state charter, and sent out an advertising circular saying:

" This step has been taken in response to an increasing demand on the part of patrons of Nebraska banks for protection under the provisions of the guaranty law. This security cannot be furnished by a national bank, the guaranty feature having been purposely omitted in the new currency law." [2]

Fourteen nationals, in all, have converted into state banks since the first failure, last November. Some give as a reason their dissatisfaction with the new Federal Reserve Bank law, so that the effect of the guaranty system in this movement is obscured; yet there is little doubt that its influence is the stronger of the two.

That the new deposits coming to the state banks are in the nature of savings rather than commercial deposits is shown by the fact that almost $11,000,000 of their $19,000,000 gain, in three and a half years, is in time certificates of deposit,[3] while the total number of depositors increased nearly 75,000. It is probable that much of the money now invested in state bank certificates of deposit at about four per cent has been brought out of hoarding, as was predicted by the early advocates of the guaranty system and claimed among its chief

[1] Letter to the writer, dated May 26, 1914.

[2] Omaha World-Herald.

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Year	Time Certificates of Deposit	Total Deposits	Number of Depositors
1909	$24.8	$71.7	224,632
1910	26.4	70.4	230,067
1911	27.2	72.2	243,333
1912	32.9	80.7	266,669
1913	37.2	89.3	296,505

The figures for deposits signify millions of dollars; e. g., $24.8 = $24,800,000.

advantages. The national bankers, however, consider this large proportion of time deposits a menace, for they say that such depositors are the most timorous of all, and are likely to want their money at the first talk of danger.

In opposition to the state bankers' argument that the guaranty will produce such a feeling of security among the depositors that runs on guaranteed banks will not occur, the national bankers contend that in Nebraska, where no bank ever failed on account of a run, there is no real danger in this direction. Sooner or later, they say, a series of failures among all banks will come, the fund will be exhausted, and the state banks will be worse discredited in the public eye than if no attempt had been made to secure their deposits. The fund is already large enough to take care of the failures of normal times, — $870,000, a little less than one per cent of the deposits. But the limit of one and one-half per cent is probably too low; two or three failures at the same time among the larger institutions would sweep the whole away. Then, if failures come one on the heels of another, as they do in a crisis, the fund must be bolstered up by special assessments that can be met only with the greatest difficulty by the sound banks, already having a strenuous struggle to meet their other obligations. If the one per cent beyond which assessments cannot be levied is not sufficient, some hastily devised system of deferred payment will be adopted. But meanwhile the frightened time depositors will have been drawing out their money; and between such withdrawals and the burdensome special assessments, the state bank system will be shaken through and through.

Both these sources of danger, the probable strain on the resources of many solvent banks, and the chance of a discreditable failure of the guaranty to meet depositors' expectations, could be removed by the establishment of a larger limit to the fund, and by specific provision for ultimate payment (after as much as possible had been paid from assets of the bank and assessment on stockholders) [1] in the form of

[1] Mr. Cooke makes both these recommendations (see this Journal, vol. xxviii, p. 104), saying that the failure of the Oklahoma plan was due to the immediate payment provision as much as to any one cause.

interest-bearing warrants against the guaranty fund. In this way the assessments would be continued at the same rate in good times and bad, building up a large surplus before the crisis and gradually paying off the bonded indebtedness of the fund afterwards. If the state banks of Nebraska had been compelled to guarantee each other's losses from 1892 to 1896 by special assessments, these would have averaged one and one-half per cent of their deposits each year; but in the twenty years from 1892 to 1912 the losses averaged but two-tenths of one per cent of the total deposits.[1] Experience in the future will doubtless show that a successful guaranty system must devise means of creating its reserve by maintaining payments through the prosperous years, when it is easiest for the banks to pay, rather than by depending on special assessments to provide the money when it is needed.

As to the policy of leaving on deposit with the banks the full amount of their assessments, which Mr. Cooke regards as unwise,[2] the only alternative would be to collect the money and then re-deposit it. To minimize the risk, the board would undoubtedly divide it among several banks, so perhaps the safest way would be to distribute it all over the state. That is precisely what the present system amounts to. The fund can hardly be invested in mortgages or bonds, so long as we have the system of immediate payment, because it is of prime importance that the money be constantly available for immediate use. If the plan of ultimate payment were adopted, as in Kansas, our Board might invest the assessments in gilt-edged bonds, which it could sell in time to meet demand on the fund. The bankers, however, have been skeptical as to the safety of a large amount of money administered by the " politicians in the state house," because of the defalcations of several state officials in the past. One advantage in the present method, therefore, is that it reduces the antagonism of the contributors to the fund.

[1] Reports, Secretary of the State Banking Board, 1892 to 1912.

[2] " This is an arrangement that might easily lead to trouble. Insurance premiums, for that is what these assessments are, should be paid over to the insurer, not held by the insured, subject to all sorts of claims and processes if the insured happens to think his insurance is proving too expensive." — In this Journal, vol. xxiv, p. 356.

Nebraska's experience seems to confirm the prophecy which was made, that a guaranty system would compel the experienced and legitimate bankers to protect themselves against the operations of rascals and incompetents within the system, and thus protect the public. The united efforts of our bankers have been transferred from fighting regulation and guaranty, as was often done until 1909, to demanding stringent regulation for the prevention of dangerous and speculative methods of business. The same act which created the fund also contained various provisions designed to make banking less hazardous to the depositor.[1] The other states have had the same experience. The excellent banking department, to which Nebraska owes much for the high standard of its state banks, will doubtless find its hands upheld more and more by the bankers, who have a new incentive for helping to prevent failures.

To conclude: Nebraska's experience indicates that in a system of efficiently organized banks, under fairly normal conditions, state guaranty is feasible and not unfair to the bankers. Whether it will survive under conditions of adversity, such as must be expected sooner or later to come, remains to be seen. If it does survive, it will facilitate considerably the commerce of the state and will relieve an important cause of individual distress.

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[1] For example, the five per cent limit on interest paid on time deposits, limit of loans to ten per cent of deposits, criminal penalties for failure to comply with any part of the law, Secretary's discretion as to need of new banks.